BEFORE THE
PUBLIC SERVICE COMMISSION OF WISCONSIN

INVESTIGATION INTO AMERITECH WISCONSIN'S UNBUNDLED NETWORK ELEMENTS	))))	DOCKET NO. 6720-TI-161

CLECS' REPLY BRIEF ON SHARED AND COMMON COSTS

AT&T Communications of Wisconsin, L.P., WorldCom, Inc., KMC Telecom, Inc., McLeodUSA Telecommunications Services, Inc., Rhythms Links, Inc., TDS Metrocom, Inc., and Time Warner Telecom of Wisconsin, L.P. (hereinafter the "CLECs"), by their counsel, submit their reply brief on shared and common cost issues. [1]

Summary

Despite its rhetoric, Ameritech's initial brief fails to address the fundamental flaws in its joint and common cost study. These well-documented deficiencies led the CLECs' witness, Brad Behounek, to make specific adjustments and corrections to Ameritech's study. His adjustments are reasonable and supported by careful analysis and governing law. These same adjustments, correcting the same flaws in Ameritech's study, have been accepted by other state commissions.

While unseemly, Ameritech's attacks on Mr. Behounek are perhaps understandable at a base level. Ameritech does not appreciate the fact that Mr. Behounek

[1] In this reply brief, the CLECs respond to arguments at pages 8-36 in Ameritech Wisconsin's initial brief. Given the voluminous record in this proceeding and the comprehensive coverage of these issues in the CLECs' initial brief, the CLECs have not attempted to reply to each and every argument asserted by Ameritech in its initial brief. The fact that an argument is not specifically replied to herein does not, of course, mean that the CLECs agree with Ameritech. The Commission is respectfully directed to the CLECs' initial brief for a full discussion of the CLECs' position on each issue.

identified (and corrected) flaws in Ameritech's study that served to increase Ameritech's joint and common cost factor, or markup, and ultimately, the rates Ameritech charges CLECs for unbundled network elements (UNEs).

If Ameritech Wisconsin's absurdly high joint and common cost markup is adopted without the CLECs' recommended adjustments, CLECs will be required to pay prices set far above economic costs and, as a result, will be unable to enter and compete in the Wisconsin local exchange market. With local competition barely emerging in Wisconsin over five years after enactment of the Telecommunications Act of 1996 ("Act"), the Commission surely does not want to take steps now to protect Ameritech's monopoly.

I. THE MARKUP FOR JOINT AND COMMON COSTS SHOULD BE "REASONABLE," NOT ARTIFICIALLY INFLATED.

At pages 8-12 of its initial brief, Ameritech selectively quotes from the Act and FCC orders to support its determination of a markup for joint and common costs. While the CLECs do not disagree with the excerpts Ameritech provides, the CLECs do take issue with Ameritech's interpretation of those passages and also with the key language that it omits.

The FCC Order in CC Docket 96-98 (the "FCC Order")[2] contains language addressing both the nature of the shared and common costs to be calculated and the method to be used for allocation. Regarding the type of joint and common costs to be calculated, the FCC Order states at paragraph 694 that "[b]ecause forward-looking common costs are consistent with our <u>forward-looking, economic cost paradigm</u>, a <u>reasonable measure</u> of such costs shall be included in the prices for interconnection and access to network elements." (emphasis supplied).[3] The FCC's use of "forward-looking," therefore, relates to its economic cost paradigm. In 47 CFR §51.505(c)(1), the FCC defines forward-looking common costs as "economic costs, efficiently incurred in providing a group of elements or services." (emphasis supplied). In paragraph 679, in describing TELRIC methodology, the FCC Order states that "[a]dopting a pricing methodology based on forward-looking, economic costs best replicates, to the extent possible, the conditions of a competitive market." It continues: "Because a pricing methodology based on forward-looking costs simulates the conditions in a competitive marketplace, it allows the requesting carrier to produce efficiently and to compete effectively, which should drive retail prices to their competitive levels."

The FCC Order also clarifies that "the network elements, as we have defined them, largely correspond to distinct network facilities. Therefore, the amount of joint and common costs that must be allocated among separate offerings is likely to be much smaller using a TELRIC methodology rather than a TSLRIC approach that measures the costs of conventional services."[4]

With regard to the allocation method to be used for joint and common costs, the FCC Order states that "[o]ne reasonable allocation method would be to allocate common costs using a fixed allocator, such as a percentage markup over the directly attributable

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[2] The FCC's First Report and Order in CC Docket Nos. 96-98 and 95-185, In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, August 8, 1996.

[3] ¶ 694 states that a reasonable measure of common costs "shall be included in ... prices." (emphasis supplied). However, ¶ 620 of the FCC Order indicates that the states "may set prices to permit recovery of a reasonable share of forward-looking joint and common costs of network elements." (emphasis supplied). The FCC appears to have intended that the amount, if any, of joint and common costs to be included in prices may vary depending on specific circumstances. For example, if unbundled network elements have difficulty passing an imputation test, a reduced allocation of joint and common costs may well be appropriate.

[4] FCC Order, ¶ 678 (footnote omitted).

forward-looking costs."[5] The FCC Order continues, however, by stating that "[w]e conclude that a second reasonable allocation method would allocate only a relatively small share of common costs to certain critical network elements, such as the local loop and collocation, that are most difficult for entrants to replicate promptly (i.e., bottleneck facilities). Allocation of common costs on this basis ensures that the prices of network elements that are least likely to be subject to competition are not <u>artificially inflated by a large allocation of common costs</u>."[6] (emphasis supplied).

Given this context, the FCC provides (and the CLECs do not object) that Ameritech may recover its legitimate or "reasonable" forward-looking joint and common costs. As the CLECs' testimony and analysis makes clear, however, Ameritech's study artificially inflates certain costs and it would be patently unreasonable for the company to recover those costs in UNE rates.

Ameritech's "the sky-is-falling" posturing that its "long-term viability would be placed in jeopardy" if the Commission did not accept its joint and common cost factor would be comical, if it were not so brazenly threatening. (Ameritech Init. Br. at 10). Facing a well-entrenched SBC-Ameritech monopoly, competition in Wisconsin has barely emerged. CLECs only provide 3-4 percent of all voice grade lines using their own facilities.[7] CLECs throughout the region have gone out of business. This lack of competition stands in stark contrast to SBC-Ameritech's glowing financial status. The company consistently reports record (or near record)-level earnings. Indeed, SBC-Ameritech's most recently reported Wisconsin return on equity is nearly 40.0%.

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[5] Id., ¶ 696.
[6] <u>Id.</u>, ¶ 696.

[7] Ameritech Competition data, Analysis of February, 2001, p. 1.

Moreover, a cursory examination of SBC's 2000 Annual Report reveals the telling lack of competition. For example, while the CLECs are being crushed under SBC's monopoly power, SBC reported near-record earnings of $7.746 billion in 2000, with an impressive $4.3 billion growth in operating revenues. More importantly, SBC, Ameritech Wisconsin's corporate parent, reported 13.2% growth in local service revenues from 1999 to 2000. SBC's First Quarter 2001 financial results paint an even grimmer picture for its competitors. SBC's monopoly control over DSL marches on unhindered, with a remarkable 39.9% growth in data revenues, and an increase in net income, despite a shaky economy.

Further numbers could be provided, but the point is clear. Competition is not making a dent in Wisconsin or SBC's other service territories. Clearly, competition is not impacting SBC's bloated earnings. The Commission need not worry that it would jeopardize Ameritech Wisconsin's "long-term viability" were it not to accept the company's artificially inflated joint and common cost markup. To the contrary, accepting Ameritech's markup without the CLECs' adjustments would sound the death knell for competition in Wisconsin.

Ameritech (Init. Br. at 10) further warns that failure to accept its joint and common cost factor will cause the company to "lose both its incentive and its ability to make needed investments in network facilities and infrastructure." Unfortunately for Wisconsin customers, Ameritech lost its incentive several years ago. Publicly available data from the FCC, the Securities and Exchange Commission and Ameritech shareholder information regarding investment and profits for Ameritech and other Regional Bell Operating Companies (RBOCs), by state, show that from 1988 through 1999, Ameritech

Wisconsin consistently lagged behind in infrastructure investment and investment in its work force. Specifically:

- **Investment**. During the period 1988-1999, Ameritech's investment per line dropped 20.8 percent, while the rest of the industry increased its investments by 5.4 percent. Annual state infrastructure investment rankings show that in Wisconsin, Ameritech's best ranking was 38 out of 50. Its worst was 50 out of 50. Also during that period, Ameritech's average annual investment per line was $104.45, compared to all other RBOCs' average of $140.26. Even with the capital budget of $339 million for 2000, an increase of $51 million over 1999, Ameritech Wisconsin's per line capital investment reached only $147, still far short of the industry average for 1999 of $161.

- **Return**. Ameritech's return on equity in Wisconsin during the period 1988-1999 has ranged from 36.4 percent to 53.2 percent, compared with returns of only four to 23 percent for RBOCs in other states.

- **Work Force**. Ameritech has cut its workforce since 1995 in its five-state region by 23 percent more than did other RBOCs. Ameritech Wisconsin's workforce cuts exceeded the industry average by 29 percent.

- **Customer Complaints**. Ameritech Wisconsin customers filed more than ten times as many complaints in the years following price cap regulation than in the period 1991 to 1994. The Commission is well aware of the complaint totals in 2000.

Clearly, the Commission need not succumb to Ameritech's argument that failure to accept the company's artificially inflated joint and common cost factor will cause the company to lose its incentive to invest in its network and infrastructure.

Finally, Ameritech argues that failure to accept its joint and common cost factor "would blunt the strong public policy in favor of facilities-based competition in the local market." (Ameritech Init. Br. at 11). While it is ironic, given its track record, that Ameritech has the slightest concern about the development of facilities-based competition, the fact is that the Act provides for and encourages multiple means for CLEC entry in the local exchange market, facilities-based entry being one preferred option. The leasing of fairly priced UNEs, which include a reasonable joint and common cost markup, are another favored means of CLEC entry. Indeed, Ameritech is obligated to provide UNEs at TELRIC-based rates. No CLEC is asking Ameritech or this Commission to impose below cost rates for UNEs, notwithstanding Ameritech's misleading rhetoric (Ameritech Init. Br. at 11). The CLECs will have the incentive to enter the local market when UNE prices are established fairly and competitively and consistent with the Act and FCC orders. This is not empty rhetoric. AT&T announced recently that it plans to enter the local phone market in Michigan on a broad scale by the end of the year to compete against Ameritech, the incumbent monopoly provider. AT&T is prepared to do so because in Michigan wholesale prices reflect the cost of providing the service.[8]

This Commission should view Ameritech's arguments for what they are: an attempt to keep UNE rates artificially high in order to deter competitive entry in Wisconsin. As described comprehensively in the CLECs' initial brief, and more narrowly below, the Commission should adopt the CLECs' adjustments and corrections to Ameritech's joint and common cost study, which result in reasonable joint and common cost markup of **   **.

II. AMERITECH'S BENCHMARKS MISS THE MARK.

Because of its numerous flaws, Ameritech's joint and common cost study yields an incredibly high markup of **   **. Ameritech asks the Commission to find this percentage to be "reasonable." Ameritech argues that the reasonableness of its proposal

[8] In making the announcement that AT&T would be entering the market in Michigan, AT&T Chairman and CEO Michael Armstrong stated with regard to UNE rates " the Michigan Public Service Commission set rates that would give competitors a reasonable chance of competing. Michigan has gotten it right and

can be assessed by looking at various benchmarks. (Ameritech Init. Br. at 13). In doing so, Ameritech carefully cherry picks the orders that purportedly help its cause.

First, Ameritech argues that this Commission's orders in AT&T's and MCI's 1996 interconnection agreement arbitrations are persuasive today. Besides being over 5 years old, and based on much different records, those orders also involved a different Ameritech cost study (Arthur Andersen study) than the one at issue here. Ameritech's current study, with its multiple systemic flaws, is what is relevant today for determining a reasonable factor. The Commission will be hard pressed to find much to guide it in a stale 1996 record. Additionally, these original arbitration proceedings were conducted within relatively short intervals, allowing Ameritech to get by with limited challenges to its proposed cost studies.

The same can be said for Ameritech's reliance on Illinois and Ohio cost proceedings in the 1996 through 1998 time period. Those proceedings involved different records and a different Ameritech joint and common cost study than what is before this Commission. Of course, Ameritech omits any discussion of how its study was received in Indiana in 1998 or Michigan in 1999.[9] Ameritech does so despite the fact that its principal cost witness admitted at hearing that the Michigan-approved cost factor is almost identical to the number proposed by Mr. Behounek here. (Tr. 991-992).[10] The Michigan Commission has seen both the Andersen study and Ameritech's new study and has both times adopted a shared and common cost percentage that is nearly the same as the one that Mr. Behounek proposes in this proceeding. The Michigan Commission's

AT&T is coming to compete. The MPSC has met the challenge of the Telecom Act." Speech by Michael Armstrong at Mid-America Regulatory Conference, June 11, 2001.

9 IURC Cause No. 40611; MPSC Case No. U-11831.

decisions deserve special attention for two reasons. First, the Michigan Commission had the advantage of reviewing all of Ameritech's shared and common costs at once. That is, the Michigan Commission comprehensively reviewed shared and common costs for both Ameritech's wholesale and retail services. Second, the Michigan Commission staff was in a position to leverage their analysis of the study with Mr. Behounek's analysis that was underway concurrently.[11]

Michigan is also particularly relevant here because AT&T recommended that Ameritech's forecasted cost savings and inflation methodology be replaced by a simple 10% across-the-board reduction to the actual account balances that comprise the shared and common cost pool. AT&T did so because Ameritech's adjustment methodology is not forward looking and was (and still is) flawed and did not (and still does not) sufficiently adjust Ameritech's costs to make them more forward-looking. Ameritech challenged the 10% reduction as arbitrary, even though it made no attempt itself within its shared and common cost study to make the study reflective of a forward-looking, most-efficient operation.[12] In the end, the Michigan Commission could not have been more emphatic:

> The Commission concludes that <u>Ameritech Michigan's shared and common cost study should not be adopted.</u> The model has a theoretical appeal, but without access to detailed underlying data, it is difficult to guard against the double counting of expenses. The methodology includes all costs in specified accounts in the shared and common cost study unless they are specifically excluded. Without

[10] This same witness also admitted that the Indiana Utility Regulatory Commission approved in Cause No. 40611 a joint and common cost factor that is "closer" to Mr. Behounek's recommendation than to Ameritech Wisconsin's. (Tr. 1023). This fact did not make it into Ameritech's initial brief.

[11] Ultimately, it should be noted that, in general, the commissions in all Ameritech states credited Mr. Behounek for identifying misallocations and related errors in Ameritech's studies. Those commissions ordered Ameritech to make adjustments and corrections.

[12] Indeed, to this day, Ameritech persists in arguing that the forward-looking TELRIC methodology is "unlawful." (Ameritech Init. Br. at 4). This Commission should have grave concerns, as do the CLECs, that Ameritech has properly implemented the TELRIC methodology in its cost studies.

> ready access to the underlying data, it is also not possible for the parties to verify that Ameritech Michigan has made the appropriate adjustments for one-time expenses and removed costs that should be assigned to a particular service. Without access to the underlying data, it is also not possible to determine whether costs associated with unregulated and regulated services for which Ameritech Michigan did not perform TSLRIC studies are excluded or included by default. Furthermore, by using actual data, Ameritech Michigan assumes that its current operations are as efficient as a forward-looking approach would yield. The Commission does not assume that there are no further improvements that Ameritech Michigan should make to its current operations. In light of the numerous flaws in the offered study and the lack of an alternative study in this docket, Ameritech Michigan shall continue to use the shared and common cost factors approved in the July 14, 1998 order in Case No. U-11280 and the May 11, 1998 order in Case No. U-11635.[13] (emphasis supplied).

Also unavailing is Ameritech's argument that AT&T and WorldCom's former use of the Hatfield Model[14] somehow makes Ameritech's proposed joint and common cost factor reasonable. (Ameritech Init. Br. at 15). Ameritech's attempted analysis looks at only a piece of the entire story. In the absence in this record of a detailed analysis of the Hatfield Model it is impossible to determine whether an apples-to-apples comparison is being made. Moreover, it is clear that Ameritech is focusing only on shared and common costs without considering the underlying TELRIC or long run incremental costs ("LRIC"), which would be critical to the analysis it is trying to make.[15]

For any given pool of costs one can sort the costs between direct, shared, and common costs. However, the distribution of the costs between these cost types will not always be the same for any given pool of costs. The extent of attribution will affect the distribution of the cost pool between direct, shared, and common costs. One attribution

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[13] Opinion and Order, MPSC Case No. U-11831, pp. 20 – 21 (November 16, 1999).
[14] The Hatfield Model is presently referred to as the HAI Model.
[15] It is noteworthy that Ameritech has not commented on the LRICs that the Hatfield Model produces. It is possible that the individual LRICs could be smaller, fewer, or both. Obviously the LRICs and shared and common costs must be looked at together. Ameritech apparently did not do so.

method could result in higher direct costs and relatively lower shared and common costs. Another method may be used where there is insufficient information to attribute as many costs to direct costs, the result of which will be relatively higher shared and common costs. The method chosen may rely on the amount of information available, the time and resources spent on the attribution, or the underlying goal of the analysis. (Tr. 2889.

For example, the Hatfield Model may be using ARMIS data that is relatively aggregated. ARMIS data combines, for example, CABS systems with other computer systems, central office buildings with corporate space, and sales expenses for each of Ameritech's business units with each other. This broader ARMIS aggregation means that the Hatfield Model tends to not attribute as many costs to direct costs, which may very well explain the reason that Hatfield's common loading factor is larger. (Tr. 2890.)

In any event, Ameritech cannot simply make general comparisons across different models and choose the results that it likes best. A proper comparison must look at the different inputs, variables, and assumptions underlying the models. The Hatfield Model's common costs cannot be examined in a vacuum and then compared with Ameritech's shared and common costs.

The final "benchmark" argument that Ameritech raises - - a strained comparison to AT&T's joint and common costs - - is no more persuasive than the others. (Ameritech Init. Br. at 16). First, assuming the financial data for AT&T and Ameritech are compiled in a similar format, it is possible that some comparisons of AT&T's and Ameritech's financial data can be made. But any evaluation of the validity of the comparisons must consider the very real investment differences necessary for the services the two companies provide. And, as was the case with the Hatfield Model comparison above, the shared and common cost percentage is only part of the story.

The LRICs, to which one would apply the shared and common cost markup, must also be examined. Since LRICs are composed predominantly of investment-related costs, a reasonable first step is to determine the investment necessary per access line served. Ameritech Wisconsin served 2,651,335 access lines using $2,979,901,000 in investment in 1998. This yields $1,123.92 in investment per access line served. AT&T, on the other hand, served approximately 99 million access lines using $21,941,200,000 in investment. This yields $221.63 in investment per access line. As can be seen from this example, Ameritech requires 5.07 times the investment to provide its local exchange services per access line as AT&T requires to provide its long-distance services per access line. (Tr. 2886) If Ameritech reduced the investments within its TELRIC and LRIC studies to a fifth of their current level it is likely that its TELRIC/LRIC costs would also be reduced to about a fifth of their current level given that the TELRIC/LRIC costs are composed mostly of investment-related expenses. Id. Therefore, if Ameritech would like to use its calculated shared and common cost percentage for AT&T of 54.60%, CLECs would probably accept that percentage as long as Ameritech reduced its TELRICs/LRICs to a fifth of their current level. (Tr. 2886).

In addition, an analysis of the difference between Ameritech's calculated shared and common costs for itself and AT&T can perhaps yield certain valuable information. Consider the composition of the differences between AT&T's and Ameritech's shared and common costs:

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Factor Component	AT&T	Ameritech
Product Support	***	***
Network Support	***	***
General Support	***	***
Corporate Overhead	***	***
Total	***	***

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From this table it is obvious that the reasons for AT&T's higher shared and common cost percentage lie in the Product Support and Corporate Overhead Percentages because AT&T's Network Support and General Support percentages are lower than Ameritech's. The reason the Product Support and Corporate Overhead expense percentages are higher is because, as explained earlier, AT&T doesn't require as much investment (and, by extension, investment-related expenses, which comprise the bulk of Ameritech's shared and common cost percentage denominator) as Ameritech does in providing its respective services to the number of access lines it serves. (Tr. 2888).

The CLECs' witness Mr. Behounek used AT&T as an example for Ameritech's shared and common costs, understanding the problems inherent in comparing two companies whose capital intensiveness is so different. Mr. Behounek did so to point out that AT&T, in its transition to a competitive environment, had to cut overhead costs significantly to be efficient and remain competitive. The CLECs can only hope that Ameritech Wisconsin faces the same situation some day.

III. THE SUBSTANTIAL FLAWS IN AMERITECH'S STUDY HAVE GONE UNREBUTTED.

Ameritech argues that the Commission only has two options in selecting a joint and common cost model: accept and use Ameritech's model or "junk it and try now, at the eleventh hour, to come up with an alternative method of determining and allocating joint and common costs." (Ameritech Init. Br. at 17). Postured in this fashion, Ameritech presumes the Commission will have to default to choosing its model. But there is a simple and reasonable third option that Ameritech neglects to mention. Ameritech's model can and should be used, but only with the modifications and adjustments identified by Mr. Behounek and Staff.[16]

The overview that Ameritech provides (Init. Br. at pp. 19-23) of its model, while mildly interesting, ignores the fundamental flaws that undermine its use. The flaws can be summarized as follows:

1. Unlike the more appropriate bottom-up methodology employed in its LRIC studies, Ameritech's shared and common cost study represents a top-down approach that provides little incentive for Ameritech to identify costs that are inappropriate for inclusion in its cost analysis. Ameritech's top-down approach also requires parties to attempt to identify inappropriate costs that are hidden within broad expense categories, which further make it more likely that these costs will remain among the shared and common costs.

2. Ameritech's shared and common cost study is based on both regulated and non-regulated cost data even though Ameritech only produces LRIC studies for regulated services (and actually, only a subset of these). Therefore, there are no cost studies for

non-regulated services to which parties can look in order to determine that the costs for these services are not also included in the shared and common costs. Therefore, Ameritech should use only its regulated expense accounts.

3. Ameritech's shared and common cost study neglects to take network growth into account. While Ameritech attempts to determine the future replacement cost for its current plant it neglects the fact that its plant investment will also increase over time. This results in an understatement of the expenses that comprise the denominator for the shared and common cost mark-up calculation, which, in turn, overstates the shared and common cost mark-up. Mr. Behounek provided a forecast of the expected plant growth from 1998 to 2001 and incorporated it into the study.

4. Within its shared and common cost study, Ameritech relies on its 1998 investments and expenses without making any adjustment to reflect efficient operations. Ameritech currently operates in a predominately non-competitive environment and has thus not been subjected to the disciplining effect of real competition. Therefore, in order to make Ameritech's shared and common costs reflective of a forward-looking, most-efficient operation, Mr. Behounek employed a 24% reduction in Ameritech's overhead costs. (*See,* Tr. Vol. 8, p. 2850, 2851.) This 24% reduction is based on the experience of AT&T, a telecommunications company that went from a monopoly to competitive environment.

5. Ameritech double counts its Plant Operations Administration and Engineering expenses. That is, these expenses are found in both the LRIC studies and the shared and common cost study. Mr. Behounek recommends that Ameritech allocate these expenses

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[16] Staff properly deleted from the joint and common cost pool all product management costs, at least in part because these costs represent marketing and advertising costs that will not be incurred with wholesale

between the LRIC and shared and common cost pools in the same proportion that Network Administration (another Network Support expense account) is allocated.

6. Ameritech misallocates Product Support costs between its wholesale and retail operations. That is, wholesale operations receive a disproportionate amount of these costs in comparison to retail operations. This skewed allocation results in an overstated Wholesale Factor by approximately 27%. Wholesale services commonly, and by their nature, generate fewer overhead costs (such as product support, sales, marketing, etc.) per unit than their retail counterpart. Therefore, one would expect the Product Support cost to be less per unit for wholesale service versus retail service. Further, the 1996 Act and the resultant FCC rules explicitly recognize that wholesale costs should be lower than retail costs through their requirement that avoided costs be removed when determining wholesale rates.

7. Ameritech improperly includes Legal and External Relations costs in its shared and common costs. CLECs should not be required to underwrite Ameritech's efforts against them. Therefore, the CLECs recommend that Ameritech remove these inflated costs from its shared and common cost pool.

A. Response to Ameritech's Defense of Enumerated Flaws

Ameritech attempts to argue that Mr. Behounek's shared and common cost recommendations are inconsistent with his own recommendations and those of other CLEC Coalition witnesses. (Ameritech Init. Br. at 28-29). For example, Ameritech claims that Mr. Behounek did not apply his own recommended changes to his maintenance factors or apply the changes to expense factors proposed by other witnesses. The fact is that Mr. Behounek could not apply these changes for good reasons: (1) he did

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UNEs. Ex. 111.

not know what the Commission's ultimate decision would be regarding these issues, and (2) Ameritech needs to input the recommended changes into its ECONS model and its maintenance factor model in order to obtain the revised factors. (Tr. 2891)

Ameritech also proposes the use of regulated account totals for the following reason:

> Costs allocated to non-regulated services reflected in the ARMIS 43-03 are not TELRIC-based cost allocations nor are they intended to be. Rather the non-regulated costs depicted represent the FCC's Part 64 fully distributed cost methodology (FDC) and are, therefore, not consistent with the objective of developing average shared and common cost loading factors applicable to TSLRIC-based costs. (*See* Tr. 591)

If we take this argument to its logical end then the entire Ameritech shared and common cost study should be rejected. Ameritech states the allocation between the regulated and non-regulated costs are not TELRIC-based. What Ameritech neglects to mention is that allocations that are not TELRIC-based produced the USOA cost data that is the basis for Ameritech's study in the first place.

The USOA cost data upon which Ameritech bases its study do not represent all of the costs that Ameritech Corporation incurs. It does not contain the costs of Ameritech's cellular operations or its alarm business or its international operations. How did a portion of Ameritech's executives' salaries get allocated to the telecommunications expenses found in the USOA accounts that Ameritech is using? How did these accounts receive a portion of human resources? One can be sure that in the determination of the USOA account balances that these allocations from Ameritech corporate were not TELRIC based. Therefore, if allocations between regulated and non-regulated services are invalid because they are not LRIC/TELRIC based, then the USOA account information on which

Ameritech's study is based must also be invalid. This would invalidate Ameritech's entire joint and common cost study. (Tr. 2893).

One final issue regarding the exclusion of non-regulated costs: Ameritech attempts to paint the picture that only the joint and common cost pool of Ameritech's joint and common cost methodology is affected by the use of regulated data. Ameritech insinuates:

> To remove a significant amount of costs from shared and common cost consideration based on a totally different cost methodology, i.e., the FCC's FDC allocation, is illogical, significantly distorts the underlying relationship between shared and common and TSLRIC/TELRIC costs, and would lead to under-recovery of shared and common costs. (Tr. 592).

The reality of the situation is that the removal of non-regulated USOA costs removes costs from both the LRIC pool and the joint and common cost pool of Ameritech's joint and common cost analysis. Second, Mr. Behounek performed certain allocations in order to achieve the costs that are the basis for Ameritech's joint and common cost study in the first place. Therefore, if it is "illogical" to use costs that are not separated based on LRIC/TSLRIC, then Ameritech's current study is illogical.

Ameritech's arguments regarding Mr. Behounek's analysis of regulated versus nonregulated costs are not relevant. (Ameritech Init. Br. at 27). Regardless of what these services are or how they are classified, Ameritech has not studied these services, or any other non-regulated services, to determine where their direct, or related shared and common costs, are found within the USOA data that Ameritech is using. When the joint and common cost study uses regulated-only USOA data, instead of the combined regulated/non-regulated USOA data Ameritech uses, the joint and common cost percentage decreases. What this says is that some of the costs that Ameritech is treating as joint and common are the direct costs of some non-regulated services. If we look at Ameritech's shared and common cost study, these costs are not identified, nor has there been an attempt by Ameritech to identify these costs.

Ameritech attempts to leave the impression that Mr. Behounek reduced cost pools directly - as in made conscious decisions regarding the numbers he changed. However, it is important to understand that the cost reductions in any particular cost category simply result from using Ameritech's regulated USOA cost data instead of its regulated/non-regulated USOA cost data. (Tr. 2896).

Ameritech also alleges that Mr. Behounek's adjustments for network growth contradict the testimony of fellow CLEC witnesses Dr. Ankum and Mr. Starkey. (Ameritech Init. Br. at 28). This is incorrect. In its shared and common cost study, Ameritech attempted to forecast certain expenses in order to determine what its expenses would be in 2001. However, Ameritech did not do this for investment-related expenses. That is, while Ameritech attempted to determine the replacement cost of its 1998-level of investment in 2001 through the application of current-cost-to-booked-cost ratios and telephone plant indices, it did not adjust for the fact that Ameritech would also add plant as its network grows. Currently, within Ameritech's joint and common cost study, certain costs (the bulk of which are joint and common costs) are forecasted forward while investment-related expenses (the bulk of which are LRIC-related) are not. This has the effect of overstating the shared and common cost mark-up. Further, Mr. Behounek demonstrated that the trends in Ameritech's investment substantiate that investment is increasing with network growth even as it replaces older equipment with more efficient newer equipment. (Tr. 2898, 2899)

Ameritech also takes issue with Mr. Behounek's proposed reduction of Ameritech's joint and common costs by 24% to reflect forward-looking efficient operations, citing that it has been subject to price cap regulation and limited competition. But this does not mean that Ameritech currently is operating in the most efficient manner. First, and most obvious, only a small fraction of Ameritech's operations have been operating in a competitive environment. The example of payphone competition is particularly amusing. In this market Ameritech commands a market share that is significantly above that held by all its competitors combined. Second, Ameritech-Wisconsin's total regulated operating revenues (regulated implying non-competitive) is 94.67% of its total regulated and non-regulated revenues. (Tr. 2899).

Price caps may mean that Ameritech is operating more efficiently than if it were not under this regulatory scheme, but price caps contain nowhere near the efficiency incentives that actual competition brings. The worst that can happen to Ameritech with price caps is to have its revenue reduced by a few percent. Effective competition has the more effective incentive that requires either that the company operates efficiently or it goes out of business.

Ameritech's argument that the 24% reduction was based on a comparison with revenues instead of directly attributable forward-looking costs is an argument based on pure semantics. Consider that Ameritech's prices will be based on direct cost, which includes a rate of return component, plus joint and common costs. That price, times the quantity purchased, will equal revenues. The bottom line is that revenue is composed of all the same elements as direct costs, which include rate-of-return, plus joint and common costs. And since Ameritech's shared and common cost calculations are based on costs not significantly different from its embedded costs, the revenue versus costs-plus-rate-of-return distinction is irrelevant. (Tr. 2900).

Finally, Ameritech continues to maintain that it is forced into incurring substantial legal expenses in implementing the 1996 Act. (Ameritech Init. Br. at 33). Ameritech freely admits that all it is trying to do is "pass on its legitimate legal expenses to all of its customers (i.e., CLECs)." Id. at 34. Ameritech undoubtedly incurs legal and external relations expense - as do the CLECs. The difference is that Ameritech would like to recover its legal costs from the CLECs - something the CLECs cannot do from Ameritech.

Fairness and equity require that Ameritech not be allowed to pass along these costs to new entrants. First, new entrants incur these same costs on their own and cannot recover them from Ameritech - as Ameritech attempts to recover its costs from the CLECs. In fact these legal and regulatory costs impose a far greater burden on the relatively small local telecommunications revenues received by the CLECs. Second, recovering these costs from the CLECs forces them to underwrite Ameritech's attempt to thwart their efforts to compete. That is, Ameritech, in its legal and regulatory battles, and through its attempts to influence decision makers through external relations, takes positions that are often flatly contrary to the interests of the CLECs. Third, Ameritech's legal and external relations efforts are coordinated principally for the benefit of the firm's shareholders and the expenses associated with those efforts should be borne by the shareholders. Finally, it is the ILECs' refusal to make their products and services available at reasonable rates and conditions that has necessitated the legal and regulatory mandates; without them, Ameritech would have no incentive to sell its services to CLECs under any reasonable terms and conditions. Ameritech should not be allowed to further inflate its UNE rates through recovery of its legal and external relations costs.

IV. CONCLUSION

Ameritech Wisconsin's model is flawed and yields an unreasonable (i.e., artificially inflated) joint and common cost markup. To salvage the model, the CLECs and Staff have made a number of discrete adjustments that should be adopted. Based on the compelling evidence in the record, the Commission should set Ameritech's Overhead Expense Loading at ** ** (*See* Tr. Vol. 9, p. 3019 and Vol. 11, p. 4349, Exh. 69).